

Weekly Macroeconomic Review

December 29, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.4% in December 0.0% in January
Future cumulative inflation – next 12 CPIs (through November 2010 CPI)		2.4%
Inflation through July 2011 CPI (average annual rate)	2.9%	2.6%
Bank of Israel interest rate, 6 months ahead	2.00% (up 0.75)	2.00%
Fed interest rate, 6 months ahead	0.45% (up 0.20)	0.45%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.50% (up 0.26)	5.25%
Yield on US Treasury 10-Year bond, 6 months ahead	4.11% (up 0.26)	4.25%
Dollar exchange rate, 6 months ahead	NIS 3.79 (unchanged)	NIS 3.75 (down 1.2%)

Israel

The **Bank of Israel interest rate** rose by 0.25 percentage points to 1.25 percent; we and most economists had seen the decision as borderline, with less than a 50 percent probability of an increase. In contrast to its earlier announcement, the BOI cited the increase in property prices, including housing, as one of the main factors affecting its decision.

Key factors leading to the decision to raise the interest rate this month:

- **Inflation.** Excluding seasonal effects and the effect of indirect taxes, the inflation environment in recent months has been in the upper part of the target range.
- Increases in property prices, including housing prices.

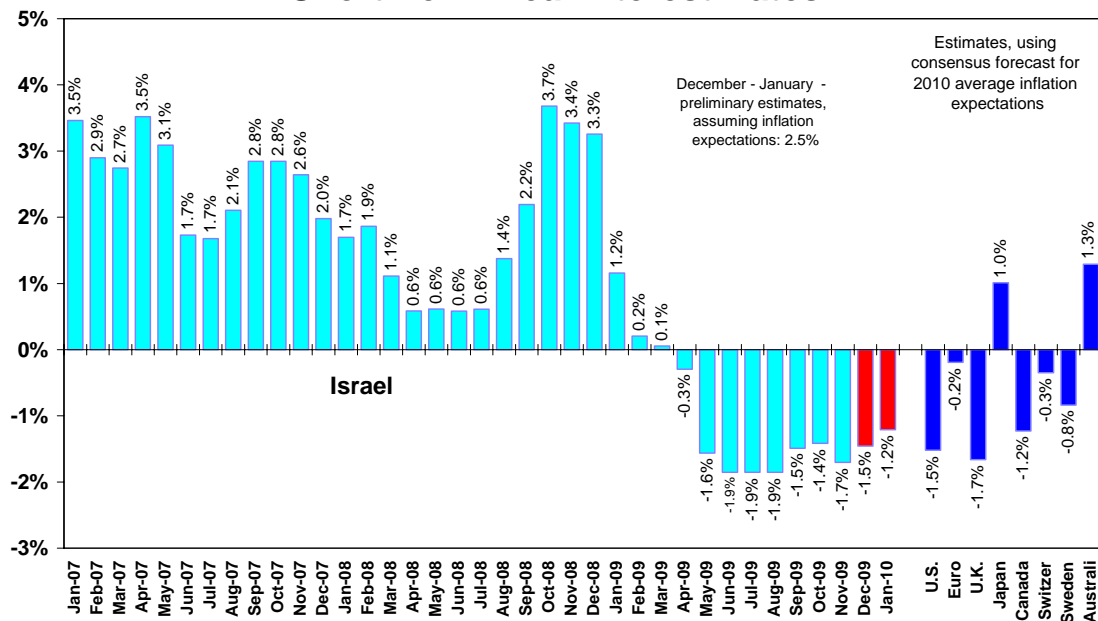


- The continued economic recovery in Israel and globally; increases in industrial production, trade and service sector revenues, and imports of goods.
- The increase in growth forecasts for many economies, following the publication of positive macro-economic data and improved production and growth.
- The improvement in the local labor market. Recent indicators showed an improvement in the labor market in the last quarter of 2009.

In addition, we note that the BOI decided to raise the interest rate despite the appreciation of the shekel since its last decision; the shekel has been stable against the dollar, but has gained 4 percent against the euro. This indicates that the prevention of appreciation of the shekel has fallen in importance in the full spectrum of the BOI's considerations, due to the improvement in exports, growth, and employment in recent months.

Despite this increase in the interest rate, the rate remains very low; if it remains this low over a long period, it will lead to the formation of significant inflationary pressures within one or two years. The BOI's announcement indicates that the current interest-rate hike is part of a gradual process of returning the interest rate to the "normal" level, but the pace of the increase will depend, as always, on local and global growth, inflation, and the pace of interest-rate increases by other central banks.

Short-Term Real Interest Rates



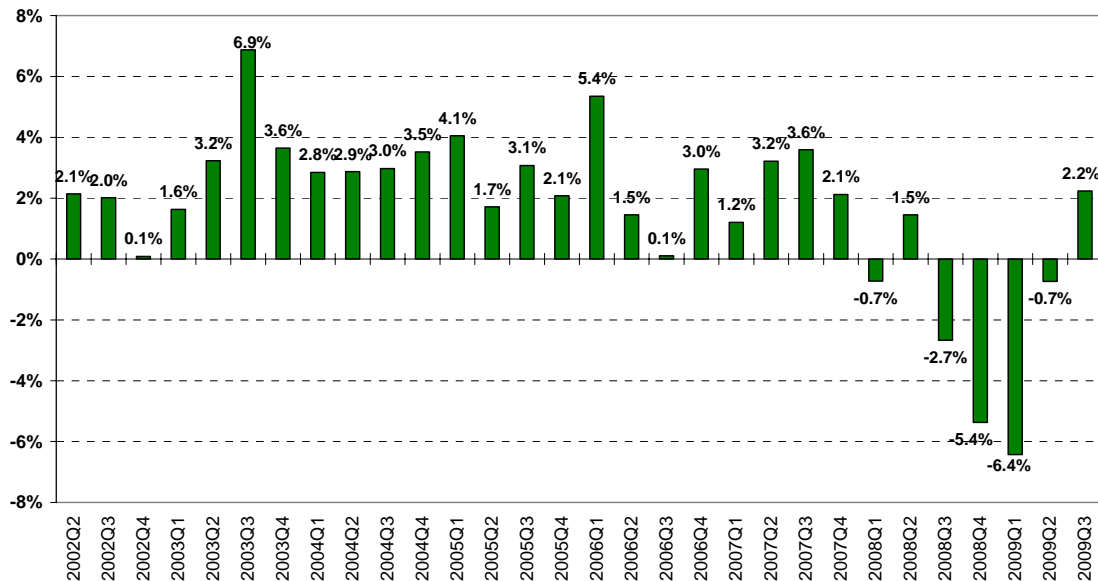
Our estimate is that the BOI will continue to raise the interest rate gradually, once every two months on average, by 0.25 points each time, unless there are significant changes in the exchange rate or in other macro-economic variables. In addition, the BOI's announcement indicates that the pace of interest-rate hikes in the coming months will also depend on developments in the equity market and in housing prices.

United States

According to the latest estimate, real GDP grew at an annualized rate of 2.2 percent in the third quarter of 2009, below expectations, and lower than the previous estimate.

The U.S. Economy

(Real quarterly growth rates, seasonally adjusted at annual rate)



Housing-market data were mixed. **Sales of existing homes** were surprisingly positive, with a 7 percent increase, but **sales of new homes** fell by 11 percent.

Private income and consumption data for November were positive. **Real private income** and **real private consumption** grew by 0.2 percent (2-3 percent in annualized terms). Households' rate of savings stood at 4.7 percent, similar to the preceding months.

Our forecast of cumulative changes in price indices due to be published during the coming three months

Forecast change, November 2009 to February 2010

Consumer Prices Index (CPI)	Housing component in the CPI (mainly rent prices)	Prices of Owner-Occupied Dwellings	Price Index of Inputs in Residential Building	Wholesale Price Index of Manufacturing (excl. Fuel)
0.3%	0.2%	0.7%	-0.4%	0.3%

Important Announcements in the Coming Week

- The Case-Shiller housing index will be published in the US on Tuesday, December 29.
- Israel's Central Bureau of Statistics will publish an update of national accounting data and data on sales of new homes on Thursday, December 31.
- The ISM manufacturing sector index will be published in the US on Monday, January 4.

This review is posted online at www.harel-finance.co.il/macro in Hebrew
and at <http://www.harel-group.com/finance.html> in English.

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